



EV/Sales – an interesting Ratio

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Enterprise Value / Sales (EV / Sales) is a financial ratio that compares the total enterprise value of the company to its sales. It is calculated by using the formula given in the Table 1.

EV / Sales ratio gives investors a fair idea as to how much it costs to investors to buy the company's sales. This ratio is an expansion of the Price / Sales valuation model, which considers market capitalization instead of enterprise value. EV / Sales is considered to be more realistic because market capitalization does not take into account the amount of long term liabilities / debt of the Company which will be paid back at a future date.

In exceptional cases, the EV / Sales measure may also be negative if liquid cash / bank balance of the company is more than its market capitalization as well as debt, indicating that the company can essentially be bought with its own cash.

As a thumb rule, higher the ratio costlier is the Company and vice-versa. Generally the lower the EV / Sales the stock is considered to be undervalued and perhaps, it can be a good investment opportunity.

However, it is recommended to take due precaution while applying EV / Sales ratio. A high EV / Sales multiple is not always a bad sign as it can be an indicator that investors believe that the sales turnover will witness quantum growth in future. Similarly, a lower EV / Sales multiple may also signal that the future sales predictions are not that bright. It is essential to compare the measure to that of other

companies in the same industry, and further look carefully into the company under analysis.

Paper Industry has shows signs of revival with some positive developments in last few weeks and future is expected to be bright if same trend continues. Table 2 highlights valuation of some of the large domestic Paper Companies using EV / Sales ratio.

Enterprise Value	

Sales	
Enterprise Value	Sales
Market Capitalisation	Total Sales of the Company
Add: Outstanding Debt	Less: Sales Return
Less: Cash & Bank Balances	

If we analyse table 2, we can find out that Ballarpur Industries and West Coast Paper have very high EV / Sales multiple as compared to peers, while companies like Paper Products and Pudumjee Pulp are getting traded at a very low multiple. Given the brand equity and market reach of large companies like Ballarpur Industries, they

Sl. No.	Company	Sales (FY08-09)	Market Capitalisation (As on 06/05/2010)	Long Term Debt (As on 31/03/09)	Cash & Bank (As on 31/03/09)	Enterprise Value	EV / Sales (X)
	Rs. Crores	(A)	(B)	(C)	(D)	(E=B+C-D)	(F=E/A)
1	Ballarpur Industries	1,022	1,954	889	10	2,833	2.77
2	Rama Newsprint	1,171	658	806	17	1,447	1.24
3	West Coast Paper	662	607	1,173	284	1,496	2.26
4	JK Paper	1,207	411	696	34	1,073	0.89
5	Paper Products	586	379	24	4	399	0.68
6	Sundaram Multipap	131	333	44	1	376	2.87
7	Pudumjee Pulp	228	88	52	1	139	0.61

are likely to get maximum benefit with the revival of paper industry and hence, Capital Market is giving them premium.

However, it would be safe to assume that the companies like Pudumjee Pulp and Paper Products are undervalued and there could be an upside potential in the days to come.